

Good MornING Asia - 6 August 2019

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By Francesco Pesole



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Source: Shutterstock

Currency manipulator?

What is interesting about China's currency action (inaction probably describes yesterday's depreciation better) is that it suggests that on China's side, there is no, or very little hope left for a sensible trade deal that would result in a "win" for them, as well as being portrayed as a "win" for the US. The CNY had been very steady when the trade talks were alive. And though it won't do a lot to help embattled exporters, a weaker yuan certainly sends a shot across the bows of the US. Is this weaponization of the yuan? I suppose it is. Although at this stage it is still more of a token display of "pique", rather than anything genuinely threatening. However, in the relatively limited act of crossing the USDCNY rubicon yesterday, China announced: "We can use the currency, don't think we can't".

The actions have resulted in calls of currency manipulation from the US President. That's not entirely inaccurate. Though we could argue all day about whether this was purely a market effect responding to economic conditions the US had imposed, or a deliberate action by the PBoC. The answer is almost certainly a bit of both. So that doesn't get us anywhere.

What we need to figure out, is how far, and how fast China intends to take USDCNY higher. Estimates of today's fixing based on its trading basket of currencies suggest another steep rise

today. If the market takes the CNY to the top of its trading range (+/-2%), then it could go to 7.10. But if the authorities set the fix a little lower, then it could signal that this move will not be allowed to run unfettered, which could restore a little confidence and stability.

In the meantime, regional currencies are getting battered, caught in the wake of the CNY move. High yielders including the IDR and PHP, INR have taken a beating. But so too has the KRW, now trading at over USDKRW 1200. Our traders are reporting central bank smoothing activity to try to stem the extent of currency weakness. Equities are also a sea of red. The JPY is acting as safe-haven and USDJPY has dropped through USDJPY 106. This will continue until some calm is restored. Probably by Beijing signaling to markets that enough is enough.

Would the US ever actively intervene to drive the USD weaker? Under G20 rules it shouldn't. But you can't ever rule anything out these days. I'm not sure Washington is that fussed by multilateral arrangements. Call it a tail risk.

RBA and RBNZ

Back in the relative tranquility of Oceania, the RBA meets today, and will likely keep rates on hold, and the RBNZ meet tomorrow, and likely won't, with a cut seeming the most likely outcome. But this is a less straightforward call than the consensus 16 cut forecasts out of 17 suggests. This morning, we have already had some fairly decent New Zealand labour market data. Employment growth is up 0.8%QoQ in 2Q19. Wages growth has picked up sharply too and the unemployment rate has ticked down 0.4pp to 3.9%.

The NZD has bounced nicely, unlike the AUD, and although I would say that the balance of risks is still tilted towards a catch-up cut, this has become a much more marginal call. I won't be at all surprised if we and the consensus get this one wrong tomorrow, in which case, the NZD will bounce further.

Rest of Asia Day ahead.

Other than that, it's a relatively quiet day in Asia. Japan has already released household spending and labour cash earnings, both of which are stronger than expected, and might help lift 2Q GDP out later this week, which consensus looks to increase by only 0.1%QoQ.

Taiwanese CPI is out and will remain very weak, at an estimated 0.79%YoY in July.

One side effect of the market turmoil that we are currently seeing is that it may deter central banks from easing until currency weakness subsides - not that we thought there was much risk of a cut from Taiwan's central bank, but it is relevant to others (BI, BSP).

RBA unlikely to help the Aussie dollar's clouded outlook

The re-escalation of trade wars and the drop in the Chinese Yuan is dampening appetite for the highly-exposed AUD. Tomorrow's Reserve Bank of Australia meeting is unlikely to deliver any cuts nor give relief to the battered currency



The Reserve Bank of Australia governor, Philip Lowe

A combination of rising trade tensions and monetary easing has kept any rally above 0.70 in AUD/USD short-lived during the past few months. As President Trump surprised the market with a new round of tariffs on Chinese exports, AUD dropped more than twice as much as its New Zealand and Canadian peers, NZD and CAD. That's hardly surprising given that Australia is the most exposed G10 economy to Chinese imports.

RBA to pause while keeping the door open for more

The lack of appetite for the Australian currency is likely exacerbated by the dovish RBA stance that keeps the rate outlook unsupportive for the currency. Rate expectations for the RBA came under pressure two weeks ago as Governor Lowe made it clear that the central bank "is prepared to provide additional support by easing monetary policy" should inflation fail to approach the target.

2Q CPI numbers, released on Wednesday, marginally beat estimates (1.6% vs 1.5%). That helped convince the markets that the RBA will keep rates unchanged tomorrow after cutting in the last two meetings; that's indeed in line with our view. Signs of a stabilising housing market will also play a role in prompting a pause in the easing cycle. At the time of writing, the implied probability

of a cut tomorrow is less than 9%, suggesting that rates are unlikely to find support should the RBA match expectations and keep rates on hold. In terms of forward-looking language, we see very few reasons for Governor Lowe to deviate from his recent dovish rhetoric, not least since the re-escalation in the US-China trade war has reignited downside risks for the Australian export-based economy.

Another cut may be delivered by the end of the year

Looking ahead, headline inflation still appears far from the (ambitious) 2.5% RBA mid-point target, which – in line with Lowe’s recent rhetoric – makes us believe that another cut may be delivered by the end of this year. Markets have already priced in an 85% probability of this happening, so further pressure on Australian rates should not be massive. However, it will remain to be seen whether, in light of the new round of US tariffs and the recent rate cut by the Fed, markets will frontload more easing by the RBA.

AUD short-term downside risks remain high

With the RBA unlikely to come to the rescue of AUD, the clouds above the currency are likely to linger for some time. Much will depend on the developments in the US-China trade war and in particular on how the tensions will impact Chinese economic data. But, for the time being, the balance of risks for the Aussie dollar remains heavily tilted to the downside. In turn, while we do not expect AUD/USD to trade far from our 0.68 forecast at the end of Q3, we acknowledge a sizeable risk of the pair moving below 0.67 in the coming weeks, especially given the absence of support from the dovish RBA.

Looking ahead, our trade team continues to expect a de-escalation in trade tensions towards the end of the year, with both China and the US making concessions on their way to strike a trade deal. Supported by a stubbornly short market positioning (-33% of open interest, as of last Friday), AUD/USD will likely have the chance to rebound towards 0.6900 in 4Q19.

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RBNZ set to cut rates

Wednesday's Reserve Bank of New Zealand is widely expected to deliver a further cut in the cash rate to 1.25%



RBNZ Governor, Adrian Orr

Catching up with the RBA and Fed

At its meeting last month, the RBNZ did not cut rates but instead, leaving rates unchanged, Governor Adrian Orr, noted that "more support from monetary policy was likely to be necessary".

Since then, not only has the Reserve Bank of Australia cut its own cash rate target a second time to 1.0%, but the US Federal Reserve also cut rates by 25bp and left it looking like they will ease further in the coming months. In short, the RBNZ looks as if it will be left behind if it does not cut rates at this week's meeting.

Not everyone agrees a cut is coming

Although only one of the seventeen economists providing forecasts for this meeting expects the RBNZ to leave rates unchanged, the "Shadow RBNZ" concluded that rates did not need cutting, noting that there were also negative consequences from excessively low rates. We don't expect

the RBNZ to take this view, however. And with the further worsening of the external outlook following the latest escalation in trade tariffs, it would be very odd indeed if the RBNZ decided to pause again.

Macro numbers also point to a further cut

The macro numbers released since the last RBNZ meeting also suggest that a cut is forthcoming. Business activity and confidence indicators have fallen further, house price growth has moderated again and the labour market is also looking softer, with expectations for some further increase in the unemployment rate.

More positively, inflation has edged a little higher, managing to rise to 1.7%YoY in 2Q19 from 1.5% in the first quarter. That said, inflation still remains well below the RBNZ target mid-point so, on balance, the macro story also seems to solidly support the notion of another RBNZ rate cut at this week's meeting.

USD/CNY pushes above 7.0

The People's Bank of China fixed the renminbi at 6.9225 today, up from 6.8996 on Friday in what they suggest is a response to the latest round of tariffs from the US. Markets have immediately taken the spot rate above the psychological 7.0 rate



USDCNY

7-broken - what now?

Today's fixing at 6.9225 was up from 6.8996 last Friday and a little more than had been expected from models looking at market swings in the basket of currencies against which the CNY is managed. Markets have immediately taken the spot USD/CNY rate above 7.0. With that level now broken, the key question is what now?

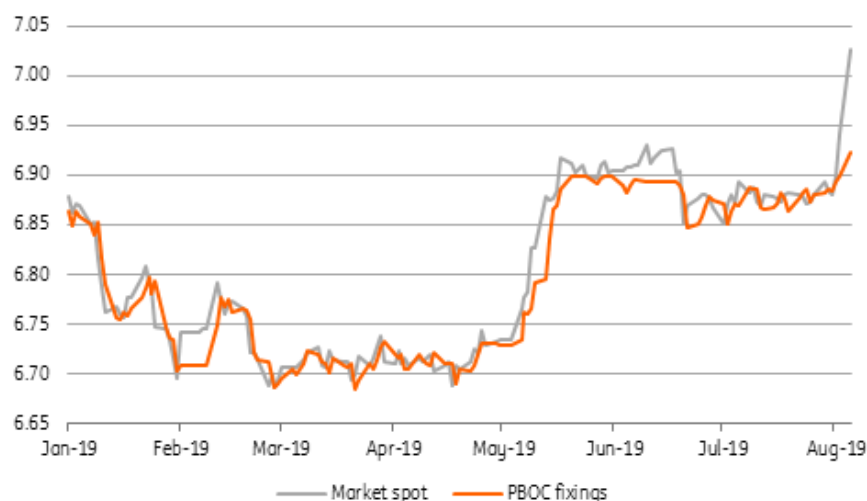
We, like most of the consensus, have been reluctant to forecast a 7+ figure for USD/CNY, at least whilst trade negotiations were ongoing, assuming that this would immediately lead to the breakdown of talks. So it is probably fair to assume that today's move was a deliberate decision, and part of what we imagine will be a concerted series of steps aimed at pushing back at the latest US tariffs. For more on this, [see the note Iris Pang published last Friday](#).

Absent from that list was any currency action. It appears the Chinese authorities no longer see the need to limit the tools at their disposal and that the currency is now also considered part of the arsenal to be drawn upon.

The [PBoC's website explicitly links the weaker fixing to the latest US tariffs](#), saying "Affected by unilateralism and trade protectionism measures and the imposition of tariff increases on China, the RMB has depreciated against the US dollar today, breaking through 7 yuan, but the renminbi continues to be stable and strong against a basket of currencies" (translated from original).

The website goes on to intimate that a move back below 7.0 is quite possible and suggests that not too much should be read into this currency movement.

China Spot FX rate vs Fixing



CNY spot vs fixing

7.0 a psychological hurdle only

With 7.0 now broken as a resistance level, a number of analysts are looking to set new forecast levels for the currency - with figures of 7.2 and 7.3 widely mentioned. In time, these may indeed be plausible levels, though the arguments against excessive weakening remain - namely, that it is likely to be damaging to the value of risk assets, such as Chinese stocks. Also, that it could result in more efforts to get currency offshore, which could tighten market liquidity and result in further economic weakness.

Moreover, we don't believe the currency is a strong transmission channel for the effective stimulus of the economy, so given the non-negligible costs of depreciation, a meaningful depreciation is not a clear choice for the Chinese authorities.

Of course, what today's move does do, by taking away the USD/CNY 7.0 hurdle, is provide much greater room for the PBoC if it does decide that the currency has to be part of the response to the latest round of the trade war.

But we're not leaping to any conclusions and will take our time in considering if this is more of a gesture of defiance (today's fixing was only 0.33% weaker than last Friday's fix) or the beginnings of a concerted currency move. The next few days fixing levels will provide some useful information.

Indonesia: 2Q GDP at 5.05%, in line with forecasts

Indonesia posted a 5.05% expansion in the second quarter of the year, slipping from 5.07% in the first but the government expects a pick-up in the second half



Source: Shutterstock

5.05% Indonesia 2Q GDP

As expected

Household consumption and government carry the load

Indonesia posted a 5.05% expansion in 2Q, in line with market expectations, with household spending and government expenditures helping to offset slowing investment and a weak external sector. The trade war continues to fester with Indonesia feeling the pinch even as government-initiated efforts to limit the current account deficit have forced import growth to contract, at the expense of investment. Going forward, with inflation relatively stable and President Jokowi

pledging reforms to help boost investment, we expect Indonesia to see an improved second half in terms of GDP, as the government chases its forecast of 5.2% for the year.

Bank Indonesia on hold for now

Despite recent easing and dovish rhetoric from Bank Indonesia's Governor Perry Warjiyo, we expect the central bank to be on hold in terms of rate cuts given the recent upswing in pressure on the Indonesian rupiah. The stability of the nation's currency will be integral in determining the timing of the next rate cut and we expect the bank to ease further in the year to boost growth, but only after the IDR has been able to stabilise after the recent risk-off tone.

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